

Michigan's Fiscal Crisis: Downsizing and Partisan Warfare (B)

It was early September, 1991 and Speaker of the House, Lewis Dodak spoke with frustration as he looked back on eight hard-fought months of budget talks with the new Republican administration of John Engler.

The Engler Administration came in with one attitude: to downsize state government by cuts and slashes, and to do it with or without the Legislature. When we started our discussions in early '91, I indicated my agreement with the Governor that there would not be any new taxes for the next two years. Part of the reason for that is a lot of us Democrats remember what happened in '83 when Governor Blanchard came in and increased the income tax. My caucus would not want to be put in the position of being set up by the Republicans [over a tax increase] and risk our majority in the House.

But Engler also did something we never thought he'd do, and that is usurp the legislative process by attempting to unilaterally make fiscal and social policy. I've told the Governor, 'Someday you're going to need legislation passed and you're going to have to deal with me. If you declare war with us, I'm going to be difficult to deal with ... extremely difficult.'

Despite numerous attempts to negotiate a fiscal 1992 budget agreement, talks had broken down and now Republicans and Democrats seemed farther apart than ever. House Minority Leader Paul Hillegonds was equally dismayed at the lack of progress.

The Democrats have been very effective at lobbing the 'mean-spirited' charge at the Governor, and at the same time we haven't done a satisfactory job of communicating the logic of our position to the public. For that reason, we have a more polarized state now which is regrettable. But I think what's most frustrating to me from a policy standpoint is that the Democratic leadership has been satisfied from day one with being an obstructionist force. It's extremely frustrating for me to see people hurting out there unnecessarily, just taken hostage in this budget battle.

With less than a month left before the new fiscal year began on October 1, neither side showed any sign of compromise in resolving a projected \$800 million deficit. Meanwhile media criticism of the partisan wrangling was increasingly strident, as seen by this editorial in the [Flint Journal](#):

Thanks in large part to the ongoing knock-down, drag-out fight [between Engler and Dodak], the state is no longer just broke, it's broken. For two men who have been in politics as long as they have, they should know better. The Governor must assume responsibility for the fiercely confrontational and sometimes insensitive and dictatorial approach of his administration. [And] the 'loyal opposition' appears far more interested in stifling Engler and posturing for partisan advantage than it is in honestly, intelligently and compassionately debating the important issues they face.

Our lawmakers are paid good money to do this. If they aren't willing or able to live up to these challenges and trusts, they should resign and allow the voters to install public servants who are up to the task.

A Compromise That Failed

In February, there were indications that partisan relations were improving. Both sides agreed that the 9.2% across-the-board cuts which had been approved the previous December were unworkable for several reasons. First, AFDC caseloads and Medicaid costs had been increasing at a dramatic pace since the previous fall which meant the state risked its federal reimbursements unless additional funds were committed. Second, the cutbacks as applied to the Department of Corrections were overruled by existing court orders which mandated increased staffing levels and reduced inmate overcrowding. "No one seriously thought that the Corrections cut would stick," said a Senate aide.

Talks between House and Senate staff had produced general agreement on the size of cuts to be made. Further negotiations between Senate Majority Leader Dick Posthumus, Budget Director Patti Woodworth and Speaker Dodak had resulted in a \$468 million supplemental appropriation that would have been funded by a series of one-time accounting changes. House Democrats, expecting further amendments, were pleasantly surprised when the Senate overwhelmingly adopted the measure on February 21. But Senate Republicans smirked that "with appropriate vetoes," the bill reflected their priorities. Said Dodak: "We've got a reasonable solution to a difficult problem. If Engler vetoes any part of it, it will be a crisis created by this Administration." The next day, the Governor signed the supplemental but vetoed nearly all its funding for social services, saying "I will continue to work with the Senate and House to resolve remaining [DSS] budget issues and to reach agreement on the means for promptly eliminating the current year's deficit." John Morberg, Director of the House Fiscal Agency and a participant in the negotiations, recalled his reaction:

I was shocked the Administration would want to set that precedent. We were clearly led to believe our agreement meant there would be no vetoes. {Engler aide} Denny Schorneck was quoted in the paper as saying they

had 'snookered' the Democrats. Well, that really infuriated people and helped drive our caucus closer together.

The vetoes were prompted by three major points of contention. First, the Administration wanted to eliminate all General Assistance (GA) funding immediately so that those funds could be used to offset the AFDC and Medicaid shortfalls. Democrats argued that GA should be phased out over a longer period of time and that job training programs should be offered to GA recipients. Second, House leadership wanted to draw down the Budget Stabilization Fund (BSF, or "rainy day fund") at a faster pace than did Republicans. And third, Democrats wanted to blunt the impact by cuts in other social services with the use of accounting changes, which the Republicans called "gimmickry."

As the Legislature prepared to recess for Easter in late March, Dodak and Posthumus again indicated publicly they were moving closer to agreement. Posthumus, who called it a "last-ditch effort" to reach compromise, offered the following plan:

- \$112 million raised through refinanced school bonds
- \$50 million through transfers from the Escheats Fund
- \$213 million withdrawn from the BSF (more than double what Engler had previously sanctioned)
- nearly \$200 million in savings from delayed payments to universities and school districts
- \$178 million in social services cuts including the elimination of the GA

Even though much of Posthumus' plan incorporated actions which House leadership had first suggested, Dodak balked saying he would not accept any cuts beyond what the Legislature had agreed to in the 9.2% reductions. Representative David Hollister, who had been a lead member of the Democratic team, called it "minuscule" movement on the Senate's part which had little meaning without the support of Engler. Representative Lynn Jondahl, Chairman of the House Taxation Committee, attacked the Senate plan as "breaking the social contract" with people on social services, "abandoning cultural programs," and "curtailing economic development activities." Posthumus responded that if Democrats were unwilling to accept the cuts, "they will get them anyway" since administrative orders by the Governor could curtail departmental spending without legislative approval.

A Compromise That No One Liked

Engler had made property tax relief a top priority in the first 100 days of his administration. His plan offered a 20% reduction in the school-based portion of each homeowner's bill, a tax exemption for senior citizens, and a freeze in

reassessments every other year beginning in 1992. Democrats had criticized the proposal as being skewed toward the rich and lacking any specific funding mechanism, though this was disputed by Pero: "we believe there will be sufficient growth in general revenues in the coming years to fund [it]."

On February 27, Dodak and Jondahl announced the \$1.1 billion Democratic plan. Its key elements were to exempt the first \$30,000 of a home's value from local school taxes, an increase in tax credits (not a full exemption) to senior citizens, renters and disabled citizens, a limitation of assessment increases to no greater than the inflation rate, and a 50% reduction in the alternative profits tax for small businesses. Moreover, the Democratic plan called for immediate implementation as opposed to Engler's 3-year phased implementation, and full reimbursement for the lost revenues incurred by school districts. And unlike the Engler plan, the Democrats specified that funding would come through the elimination of the capital acquisition deduction used by Michigan businesses when filing their Single Business Tax forms (\$500 million) the elimination of industrial tax abatements (\$115 million), the reduction of property tax credits resulting from lower taxes (\$325 million), and the reduction of "personal services contracts" (\$230 million). The inclusion of this last funding source was at least partly prompted by what Democrats considered a political gaffe by the Governor. Engler had dramatically held up a copy of these contracts in his State of the State message, calling them a \$500 million "incubator for abuse," and had promised to weed out and cancel any wasteful contract that could not be justified. To his embarrassment, this brought a howl of protests from Republicans whose constituents and business contacts benefited far more than did Democrats. Engler had since quietly dropped the idea.

On March 7, the House passed the Democratic plan on a 66-36 vote which drew 11 Republican supporters. That same day, Senate Republicans amended the Governor's property tax plan by boosting the homestead tax reduction from 20% to 33% over a three year period and increasing tax credits for senior citizens, rather than a full tax exemption. The Senate Fiscal Agency projected a FY92 impact of \$1.1 billion and a FY94 impact of \$2 billion when fully implemented. The media heralded the votes as significant progress toward tax relief and urged prompt final action. Legislators were less sanguine: neither side was in a mood to be agreeable and both understood that property tax relief would compound the difficulty of closing sizable budget deficits. Yet Republicans and Democrats alike were under immense pressure to act, or at least to avoid blame for scuttling the latest effort at tax relief. After several negotiating sessions, Engler and Dodak announced a compromise agreement to freeze assessments in 1992 and to place a constitutional amendment on the ballot that would permanently limit assessment increases to the lesser of inflation or 5%.

The compromise immediately drew fire from all sides. Local government and school officials charged that the Governor was practicing his own version of “Reaganomics” by pushing state costs down on municipalities. Engler argued that it was “an important first step” and that he would continue to push his own plan in the Legislature. But business leaders angrily complained that the compromise removed any pressure on the Legislature to act. “What we’re seeing is a wretched reneging on campaign pledges,” said David Littman of Manufacturers National Bank. Similarly, community tax-cut activists denounced it as a “stop-gap measure” and “a political ploy” that did nothing to address the underlying causes of tax increases. The Detroit Free Press, under the headline “Simple-minded Remedies Can only Hurt State,” blasted both parties for “flailing about on budget cuts and a hasty embrace of the across-the-board tax freeze.”

The Legislature, in mandating such a freeze, would have to deal with none of the budget implications. That would be left to local governments, to school systems, to already strapped cities. Moreover, at a time when the state is telling cities it can no longer support cultural institutions, the Legislature is going to move arbitrarily to limit tax revenues. Who is going to fill that void?

Dodak, who had earlier called the measure “a quick fix [and] a false hope,” challenged the Republicans to put their tax cut plan up against the Democrats’ on the 1992 ballot. By early June, both parties had mounted petition drives to do just that.

A New Breed of Managers

In the Engler Administration’s rush to downsize government, it could not afford the luxury of conducting extensive searches to fill top agency positions. So it relied on a ready source of talent – the Senate Fiscal Agency. Patti Woodworth, Engler’s SFA director when he was Majority Leader, was named Treasurer. Gerald Miller, who had been Governor Milliken’s budget director before going to Washington for a stint with the National Governors Association, was brought back to head Social Services. And Art Ellis, who had been the SFA’s first director in 1965, was named to head Commerce. “We’ve brought in a new breed of managers,” boaster Pero. “They aren’t tied to the bureaucracy and they’re not program advocates, but they do know how to downsize and live with what they’ve got.”

Ellis in particular seemed to fit this role. He was an outsider to the state bureaucracy, having spent nearly 20 years in Michigan higher education, retiring from his post as President of Central Michigan University in 1988. He had no particular affinity for the Commerce Department: “I told John I’d be happy to help wherever he needed me.” And Ellis had known Engler for nearly 20 years and was wholeheartedly in support of

the Governor's agenda. "By the time John became Governor, he didn't need to tell me what to do," Ellis recalled.

My charge was no more specific than to dramatically reduce what John and I both considered excessive expenditure and to get them out of the GF-GP budget. When I started, the Commerce budget was around \$117 million. After the first nine months of the Engler Administration, we began FY92 with a budget of \$62 million and we only had to layoff 100 people to get there.

Within his first 100 days, Ellis had dramatically altered the way Commerce did business. His first move was to eliminate the graphic arts shop. Symbolically cutting the Department's ties to Blanchard and his heavy use of the group for political advertising. He shut down the Neighborhood Builders Alliance, a \$10 million "patronage boondoggle", and cancelled the state's sponsorship of events such as the Detroit Grand Prix auto race and the Buick Open golf tournament. Also eliminated were some \$10 million in state subsidies to 123 local and regional economic development agencies. "We took a lot of heat for a month on that," said Ellis. "Then we found that those groups which had a function and did good work picked up the slack through private contributions and are just as strong now." By executive order, Engler abolished the independent Department of Licensing and Regulation and moved its functions into Commerce where Ellis stripped it of \$3 million in administrative overhead. Also reorganized into Commerce by executive order were the Insurance Bureau and the Arts, Film and Cultural Affairs Bureau. Reflecting on his early accomplishments, Ellis spoke candidly:

I probably couldn't have gotten away with some of the things I did if someone had looked carefully and challenged my authority. But quite frankly, nobody wanted to expose the excesses of these programs. I've been in and around state government for almost 30 years so I know the system and people and they know me. I take the time to explain things properly and I listen to what legislators have to say. A leading Democrat said to me, "look I know you have to do this; just don't ask us to support you." We can come to an understanding that way, you see. Unfortunately, some of my friends in the Administration would rather just shove things down people's throats.

One area where the Administration had clearly faltered was its effort to slash funding for the arts. "the arts cuts were a royal edict that hurt Republican supporters more than Democrats," said Democratic Senator Jack Faxon. "But that didn't faze Engler - he just plowed ahead." Against blistering public and media criticism, Engler first agreed to postpone the cuts until fiscal 1992 and then was forced to reduce the scope of the cutbacks, sometimes settling for their reorganization within Commerce. Still most

cultural institutions were cut 20% to 30%. To strong arts supporters like Senator Faxon, the cuts represented the Administration's heavy-handed approach to government.

I have never seen a caucus so dominated by a Governor. Posthumus is ineffective as a caucus leader and unwilling to take any position contrary to Engler. I was able to get [Republican] Senators Schwarz and Ehlers with me on the first vote to restore \$1.5 million for the Arts Council but they switched in second reading saying, "It wasn't worth political death!"

Another sweeping effort by the Engler Administration was to establish privatization of government functions as a policy option. In 1991, plans were offered to privatize Michigan's liquor distribution system, its Accident Fund for disability insurance, a large part of its mental health services through deinstitutionalizing patients into community clinics, and some of the state's larger parks. House Democrats, who themselves had suggested the privatization of liquor distribution (albeit on a slower schedule), charged that the Governor was willing to sacrifice the public interest for the sake of a lower payroll. Even some of Engler's former Republican colleagues were worried. "On some of these issues, John is way out front of a caucus which isn't as ideologically committed as he is," said one privately,

The liquor distribution plan in particular was controversial. The state operated three large warehouses 73 wholesale distribution centers and a fleet of trucks to move inventory between these and thousands of retail outlets. In FY91 this was a \$43 million operation and to Art Ellis, an ideal opportunity to privatize.

Privatization of the liquor distribution business has been every bit as difficult as people said it would be. The system in place now has been there since Prohibition and works quite well for the liquor industry. But I think we could make it work just as well as a private business while saving the state millions. Even though liquor sales have declined, which most people think is permanent, our costs continue to increase because of civil service provisions. That is, we virtually cannot control the bulk of our costs.

What we have proposed is to eliminate the 73 wholesale centers, keep the warehouses, and contract out the distribution operations. We've already done this in the Detroit area and it works well. Estimated savings are \$20 million the first year and \$15 million thereafter. The Legislature is resisting but sometimes you just have to make up your mind and do it. I've given the Governor a plan which shows what we can do without legislative authority and that is to shut down those 73 stores administratively.

A Constitutional Confrontation

For the most part House and Senate leaders were so busy trying to resolve Michigan's fiscal crisis, they had little time or energy to investigate the administrative moves of the Commerce Department. The 9.2% cuts had gone into effect at DSS and other areas where Engler had vetoed the supplemental appropriation in February. Negotiations dragged on through mid-April without much progress. Engler, who had watched his plans for quick property tax relief vanish into the growing deficit, now redoubled his efforts to resolve the FY91 impasse so his Administration could focus on FY92.

The most significant issue that prevented agreement was the size of further DSS cuts, including the elimination of GA. There was agreement that the size of the remaining problem was between \$150 and \$170 million and that the other \$650 million or so of the deficit could be covered using the BSF, accounting adjustments for property tax refunds, school bond refinancing, and other technical measures. But there the agreement ended. Engler insisted that the remaining gap be made up from cuts; Dodak insisted that no more than \$110 million should be cut. On April 18, Engler issued a well-publicized ultimatum: either the difference was resolved by April 26 or the Governor would take unilateral action. After three days of intense meetings, Posthumus appeared hopeful that an end was in sight; "Basically we came out of that meeting optimistic that all sides were moving and that there were areas where we could reach agreement." The talks continued. Again on May 4, Engler reiterated his ultimatum and indicated his patience was wearing thin. At a press conference in Warren, Dodak cautioned the Governor that he should be "focused on settling difference, not issuing ultimatums."

Finally on May 7, Engler broke off the talks and announced that he would bring a series of budget transfers before the Michigan Administrative Board, a six-member group of which Engler was a member. "We feel the FY91 budget talks have gone on long enough," said the Governor. "When the Legislature does not do its work, somebody has to. This sends a message to the Legislature that they can't sit on their duff." The Ad Board, as it came to be called, was established in 1921 a then part-time legislature that was reluctant to be called into special session whenever a claim against the state required a transfer to be made. The Board had been infrequently utilized since the 1960's and had only met twice since 1988. Yet it had no difficulty in approving the Governor's 11 transfers; there was only one dissenting vote on the motion to cut off GA funding on May 30.

Dodak was furious: "This is one of the greatest constitutional crises the state has ever faced because the Board's actions violate the separation of powers between the executive branch and the legislature. He immediately filed suit in district court, charging "the Governor has declared war on the legislature," John

Truscott, Engler's press secretary, responded by saying that even if the lawsuit was successful, "[the Democrats] will wind up harming some of the most vulnerable people in the state...by opposing the restoration of cuts in Medicaid, county medical services, foster care, and adoption services. This further enraged House leadership, which pointed out that the major point of disagreement was over Engler's deep cuts in exactly those areas.

The week of May 15 saw emotions reach the boiling point in Michigan's legislature. It began when an argument between liberal Democratic Senator John Kelly and conservative Democratic Senator Gilbert DiNello ended in fisticuffs on the Senate floor as 35 fourth-graders watched from the gallery. Two days later, the House learned that DSS had decided to stop payment on welfare recipients' water bills due to lack of funds. "I have never in all my life witnessed this government stoop so low," shouted Representative Dominic Jacobetti, Chairman of House Appropriations. Fueling the debate was remark attributed to a DSS Deputy Director that the poor could always borrow water from neighbors. "We cannot allow Michigan to turn into a kind of Third World county that doesn't provide food and water [to its needy]," said Representative David Hollister. The House voted 101-0 to urge DSS to reverse its decision. On Friday, the District Court ruled the Ad Board's transfers were legal. Dodak moved the case to the Appeals Court which issued a temporary injunction on the transfers until the Court made its ruling. While both sides awaited the outcome of the lawsuit, the legislature's work aground to a halt. Michigan's government was paralyzed.

Despite Agreement, Stalemate Continues

On June 6, the Appeals Court ruled unanimously that Engler and the Ad Board had acted illegally. Dodak called the ruling a "major victory" for the Legislature and called on Engler to come back to the bargaining table. "My number's still listed," replied the Governor. This time, it was Engler who appealed the case to Michigan's Supreme Court but he realized that time was not on his side. On June 14, Engler, Dodak and Poshumus finally announced they had reached a resolution of the FY91 deficit. The major elements were continued funding of the GA through the end of the fiscal year (though recipients' checks were reduced by 30%), \$179 million in cuts but restored funding of \$184 million primarily in DSS, and nearly \$800 million in one-time accounting changes were made to balance the budget. Predictably, there was criticism immediately from Republican supporters who were disappointed by the GA's sudden resurrection, and from Democratic supporters who had hoped that more human services could be spared. Both Dodak and Engler emphasized that the agreement did not include any tax increases nor any cuts in education, but also acknowledged that its heavy reliance on accounting changes meant the FY92 budget was deeper in deficit. There was also a sense of relief around the Capital that the two warring factions

had been able to reach a compromise, or as the Flint Journal put it, “[managed] to bury the hatchet somewhere beside each other’s skull for a change.’ The paper went on to urge Engler and Dodak to continue their “step back to sanity.”

But the FY91 pact only made it that much more difficult to balance the FY92 budget. The DMB estimated in late June that FY92 revenues would be no better than flat and warned that even if Engler’s package was approved without any further spending, the budget would still be in deficit by nearly \$1 billion. The Senate began to act on a series of bills that scaled back spending but the Democrats remained unconvinced. On June 26, the House approved, on a 56-48 vote, a new job training program for GA recipients that would pay reduced benefits during training. Nicknamed SWAP (for State Worker Advancement Program), it required participants to enroll in either an educational program, like a GED course or vocational education, or be placed into a job. “65% of the people polled think that’s the right way to go,” claimed Hollister. “The public will accept this program as long as the recipients are willing to help themselves.” The next day, the House voted 55-46 to spend \$2.5 billion on DSS, \$367 million above Engler’s recommendation. By early July, the House had passed all its major appropriations bills which totaled \$8.8 billion, or \$1.4 billion beyond DMB’s revenue estimate. On the floor, Hillegonds chastised the Democrats: “We can hope for an economic miracle and hope that revenues next year increase by 24 percent, or perhaps there are some on that side of the aisle who would balance this budget by raising the state income tax!”

In fact there was increasing talk within Democratic circles of increasing cigarette, alcohol or gasoline taxes but House leadership was against any move in that direction unless the Governor first proposed it. “I do think that Engler will eventually have cost overruns in both Corrections and Mental Health which will force him into it.” said Representative Dick Young, the respected Vice Chair of Appropriations. “But there is no chance this caucus will vote to raise taxes without a Republican endorsement.” Representative Jim O’Neill, Chair of the Appropriations subcommittee on education, dismissed the notion of new taxes altogether.

In my view, taxes are not an option; the public won’t stand for it. I agree with the Governor that spending cuts must be made and that we should make every attempt to spare education. In the past, the education budget has been set in a bipartisan fashion and I expect it will go that way again this year.

Senate Minority Leader Art Miller believed the Democratic strategy should be to de-emphasize GA funding (“a political loser”) and highlight Engler’s “mean-spirited” attempts to cut programs for the elderly and disabled: “media and public attention will

force him to restore funding for things like day care for working mothers and nutritional programs.” The Speaker viewed the issue differently.

My argument with John Engler was not over eliminating GA or downsizing government but that he wanted to do everything within 100 or 200 days. We thought we could do it in a different manner – by slowing the process down and taking our time. I told the Governor, “OK, GA is gone but let’s give them the chance to get a job.” But he wasn’t offering any transitional programs, he just wanted to cut programs he didn’t like. Even when we had agreements with Posthumus and Woodworth, Engler would veto projects and accuse us of “pork barrel” spending.

In mid-August, the House Fiscal Agency released a report signed by Representatives Jacobetti, Young, Hollister and Johndahl entitled “Investment Budgeting: Moving Back to Michigan’s Future.” It argued that further downsizing of state government would endanger Michigan’s long-term economic prospects by disinvesting in critical infrastructure needs, primarily transportation, housing and telecommunications. While it emphasized that spending more on infrastructure needs, primarily transportation, housing and telecommunications. While it emphasized that spending more on infrastructure investments “means spending less elsewhere,” the report did not specify or endorse any changes in non-investment spending. The Representatives’ letter concluded:

Governor Engler’s strategy for Michigan’s future represents a riverboat gamble – a gamble in which we must not participate... Rather, we must resolve to do what is right and not what is politically popular. Compared with attacks on government and taxes, the investment message may not be as popular in the short run, but it is far more important.

The report did not go over well in Lansing. Republicans ridiculed its conclusions as “a recipe for bankruptcy” and “warmed over New Deal prescriptions.” Moderate Democrats worried that the liberal wing was going too far. One said privately, “I’m seeing a more fractured, fragile caucus, especially around the welfare cuts. The feeling in the suburbs is, “if it hurts Coleman Young, I’m for it.” Dodak’s statements to the contrary, you get the feeling he’s not eager to fight this battle.” Representative Roland Niederstadt said, “In my view, roughly two-thirds of the caucus is liberal and it’s this group which has driven Dodak toward conflict.” But House Majority Leader Pat Gagliardi defended the leadership:

There’s some validity to the criticism that the liberals have been too outspoken but we have stayed together as a caucus. House Democrats have agreed to downsize and not increase taxes as a traditionally liberal

caucus might be expected to do. And Engler has lost the debate; we've been able to tag him as mean spirited and insensitive to the needs of the disadvantaged.

On the Republican side, there seemed to be little disagreement over the Administration's strategy. "Our caucus may at times quarrel over tactics," said Senator Posthumus, "but we have a solid, shared vision." With less than a month left before the new fiscal year began on October 1, little progress had been made to resolve the differences of the House and Senate.